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What Appeals Are Permitted by Section 16(a)(1)(A) of the Federal Arbitration Act?

by Jay E. Grenig

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ISSUES

Does Section 16(a)(1)(A) of the Federal Arbitration Act provides appellate jurisdiction over an appeal from an order denying an application made under Section 3 to stay claims involving nonsignatories to an arbitration agreement?

Does Section 3 of the Federal Arbitration Act require a district court to stay claims against nonsignatories to an arbitration agreement when the nonsignatories can otherwise enforce the arbitration agreement under state law principles of law and equity?

FACTS

The respondents sold their construction equipment business and sought advice on how to minimize the taxes on their sale from petitioners Arthur Andersen, LLP, an accounting firm; Bricolage Capital LLC, a "financial boutique"; and Curtis, Mallet-Prevost, Colt & Mosle, LLP, a law firm. These petitioners recommended investment in a tax shelter referred to as a "leveraged option strategy" involving foreign currency exchange options. Following this advice, the respondents each created separate business entities, consisting of limited liability companies, to implement the leveraged option strategy. These limited liability companies then entered into investment management agreements with Bricolage Capital LLC. Petitioners Arthur Andersen and Curtis Mallet were not parties to the management agreements, which contained the following arbitration clause:

> Any controversy arising out of or relating to this Agreement or the breach thereof, shall be settled by arbitration conducted in New York, New York, in accordance with the Commercial Arbitration Rules of the American Arbitration Association.

As a condition of participating in the tax shelters, the respondents

(Continued on Page 314)

ARTHUR ANDERSEN LLP ET AL. V. CARLISLE ET AL.
DOCKET NO. 08-146

ARGUMENT DATE:
MARCH 3, 2009
FROM: THE SIXTH CIRCUIT

Case at a Glance

The defendants, who were not parties to an arbitration agreement, unsuccessfully invoked equitable estoppel in an attempt to stay claims brought against them by the plaintiffs, who were parties to the arbitration agreement. The district court denied the stay and the defendants filed an interlocutory appeal. The plaintiffs are asking the Supreme Court to determine whether an appeal may be taken from a district court's order denying a stay application made under Section 3 of the Federal Arbitration Act.

were required to invest over $4 million in warrants to purchase stock of unidentified small, high-tech companies. The respondents formed another entity, Respondent WJC Strategic Investments, to buy the warrants, which were eventually found to be worthless. The respondents also signed individual retainer agreements with petitioner Curtis Mallet, for a fee of $100,000 each.

The IRS later determined that the "leveraged option strategy" was an abusive tax shelter but offered amnesty to taxpayers who had invested in them, under certain conditions. The petitioners did not inform the respondents of these IRS rulings and the respondents were eventually forced to join an IRS settlement program that required them to pay taxes, penalties, and interest due to federal tax authorities of more than $25 million.

Respondents filed suit against nine defendants, including Arthur Andersen, Bricolage Capital, and Curtis Mallet, alleging fraud, negligence, civil conspiracy between the defendants, and breach of fiduciary duty, among other counts. Relying on the arbitration agreements with the principal plaintiffs, Bricolage Capital filed a motion to stay the proceedings pending arbitration of disputes arising under the management agreements. While that motion was pending, Bricolage Capital notified the court that it had filed a petition in bankruptcy; an automatic stay as to Bricolage Capital was subsequently entered.

The respondents sought to step into Bricolage Capital's shoes, seeking their own stay of the proceedings based on their theory that equitable estoppel should prevent the respondents from "avoiding arbitration" under the contracts between Bricolage Capital and the respondents, and, as a result, that the arbitration clauses in those agreements should be binding on the petitioners as against all respondents. The doctrine of equitable estoppel provides that ordinarily a party should not be allowed to argue a position that contradicts its earlier position upon which another party relied. The district court rejected the petitioners' equitable-estoppel argument and denied the motion to stay. The petitioners then sought appellate review of that denial, invoking Section 3 of the Federal Arbitration Act in an effort to establish interlocutory jurisdiction (that is, jurisdiction to hear their appeal regarding that specific question of law even before the district court had entered final judgment in the case) under Section 16 of the Act. The U.S. Court of Appeals for the Sixth Circuit dismissed the appeal, holding that the order denying the stay for arbitration of the dispute to which the respondents were not signatories was not immediately appealable under the Federal Arbitration Act. *Carlisle v. Curtis, Mallet-Prevost, Colt & Mosle, LLP,* 521 F.3d 597 (6th Cir. 2008). The court explained that an interlocutory order denying a stay for arbitration under an arbitration agreement to which the moving party was not a signatory does not involve "any issue referable to arbitration under an agreement in writing" so as to be immediately appealable under the Federal Arbitration Act.

Petitioner's request for request for review of the Sixth Circuit's decision was granted by the U.S. Supreme Court. *Arthur Andersen LLP v. Carlisle,* 129 S.Ct. 529 (2008).

Case Analysis

The issue arises in the context of a limited statutory exception to the general rule of appellate jurisdiction under 28 U.S.C. § 1291, giving courts of appeal jurisdiction only over "final decisions" of the district courts. A final decision is one that "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Catlin v. United States,* 324 U.S. 229 (1945).

Judicial proceedings against parties to an arbitration agreement are generally stayed pending outcome of arbitration. Denials of motions to stay judicial proceedings are not appealable as interlocutory orders denying injunctions under 28 U.S.C. § 1292(a)(1). See *Gulfstream Aerospace Corp. v. Mayacamas Corp.,* 485 U.S. 271 (1988). Section 16(a)(1) of the Federal Arbitration Act (9 U.S.C. § 16(a)(1)) confers jurisdiction over interlocutory appeals from the denial of a motion to stay under Section 3 of the Act (9 U.S.C. § 3) or to compel arbitration under Section 4 of the Act. (9 U.S.C. § 4). In addition, 9 U.S.C. § 2 provides that, with specified exceptions, a "written provision" evidencing a transaction involving commerce to settle by arbitration a controversy arising out of the contract is valid and enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract."

Section 3 of the Federal Arbitration Act makes available a stay of proceedings based upon "any issue referable to arbitration under an agreement in writing for such arbitration." The denial of a stay under Section 3 is subject to interlocutory review under Section 16. Respondents argue that the arbitration provisions in the investment management agreements between the respondents and Bricolage Capital permit them to seek a stay under Section 3 because the action brought by the plaintiffs involves an issue that is referable to arbitration under "an agreement in writing." They argue that this is so even if the respondents are not signatories to the written agreement in question

and are seeking to compel arbitration with the signatories to a contract with a third party that is no longer involved in the judicial proceedings.

The petitioners assert that the Sixth Circuit committed two errors of statutory interpretation, first as to Section 16(a)(1)(A), and then as to Section 3. They ask the Supreme Court to reverse both errors and remand this case to the Sixth Circuit to consider petitioners' arguments that respondents' claims are "referable to arbitration" under the doctrine of equitable estoppel.

The petitioners argue that the Sixth Circuit erred by deciding appellate jurisdiction under Section 16(a)(1)(A) by reference to its determination that on the merits, Section 3 does not apply as a matter of law to claims involving nonsignatories. The petitioners claim the text of Section 16(a)(1)(A) conditions appellate jurisdiction upon only two elements: first, that the appellant sought relief under Section 3, and second, that the district court denied such relief. The petitioners say they satisfy that simple test, as they made their motion under Section 3 and the district court denied it. According to the petitioners, any purported substantive defect in their Section 3 motion speaks only to the merits of their request for Section 3 relief, and is therefore irrelevant to the question of appellate jurisdiction.

The respondents say the issue in this appeal is whether petitioners, as nonparties to the arbitration agreement who unsuccessfully invoked equitable estoppel in an attempt to force respondents to arbitrate with them, have an automatic right to an interlocutory appeal from the district court's refusal to stay respondents' claims against them pending arbitration.

Respondents point out that the petitioners invoked Section 16(a)(1)(A) as the jurisdictional basis for their attempted interlocutory appeal, and that Section 16(a)(1)(A) limits the interlocutory jurisdiction it confers to orders refusing a stay under Section 3.

The petitioners say their textual reading of Section 16(a)(1) is confirmed by the structure of the Federal Arbitration Act's provisions for appellate review, under which all orders hostile to arbitration under Sections 3 and 4 are immediately appealable, whereas all Section 3 and 4 orders favorable to arbitration are not. By its interpretation of Section 16, the petitioners contend the Sixth Circuit in effect created a new subcategory of banned interlocutory appeals—a subcategory absent from the text of Section 16.

The respondents disagree, claiming the text of Section 3 could not be clearer: the predicate for a stay under Section 3 is an issue "referable to arbitration under an agreement in writing for such arbitration." They say that petitioners' status as nonparties to the arbitration agreement, who therefore had to invoke equitable estoppel, signaled that they had no written agreement with respondents requiring them to arbitrate their claims against petitioners. Because Section 3 requires such an agreement, the respondents say the petitioners could not seek a stay under Section 3. According to the respondents, the stay that petitioners requested and the district court refused to grant did not and could not fit within the language of Section 3. Because of this, respondents claim the order rejecting that stay could not be immediately appealed under Section 16(a)(1)(A), given that the interlocutory jurisdiction it confers is limited to orders refusing a stay under Section 3.

The petitioners contend their interpretation of Section 16(a)(1) is further supported by the Supreme Court's decision in the analogous context of immunity appeals in *Behrens v. Pelletier,* 516 U.S. 299 (1996). Under that decision, appellate jurisdiction is determined "by focusing upon the category of orders appealed from, rather than upon the strength of the grounds for reversing the order." They say the Sixth Circuit's analysis inverts the *Behrens* test by focusing not on the category of order appealed from (denials of Section 3 motions) but instead on the merits of an appellant's arguments for reversal.

The petitioners argue their interpretation of Section 16(a)(1) is supported by considerations of judicial efficiency. They contend their theory establishes a clear, bright-line test for appellate jurisdiction: Was Section 3 relief sought and denied? The petitioners claim this test should not disrupt district courts or burden courts of appeals with groundless Section 16 appeals. In *Behrens,* the Supreme Court approved of procedures adopted in several circuits for district courts to certify appeals as frivolous, thereby permitting district courts to retain jurisdiction pending appeal.

The petitioners also contend the Sixth Circuit erred in its interpretation of Section 3, pointing out that the Sixth Circuit held the petitioners' Section 3 motion failed as a matter of law because there was no "written agreement to arbitrate" in view of petitioners' status as "[non-]signator[ies] to the written agreement in question." The petitioners reason that the centerpiece of the FAA is Section 2, under which statelaw principles of "law and equity" generally applicable to contracts dictate the validity, revocability, and enforceability of arbitration provisions. They rely on

(Continued on Page 316)

Perry v. Thomas, 482 U.S. 483 (1987), in which the Supreme Court recognized that whether a nonsignatory can invoke a written arbitration provision turns not on the text of the FAA, but on state law principles made applicable by Section 2; whether the "arbitration provision inures to the benefit" of the nonsignatory is determined under such state law principles. Thus, the petitioners assert that state law principles of "law and equity," and not Section 3, control whether petitioners may enforce the arbitration agreement.

According to the petitioners, it is indisputable that "hundreds of years of common law" recognize that "non-parties" may enforce or be bound by contracts. Applying such principles, the petitioners say courts have routinely held that nonsignatories may enforce or be bound to arbitration agreements under myriad theories, including equitable estoppel. By exempting arbitration agreements from such ordinary common-law rules applicable to contracts, the Sixth Circuit's categorical rule runs contrary to the very purpose of Section 2: to place arbitration agreements on an equal footing with other contracts.

It is the petitioners' position that the Sixth Circuit's reliance on Section 3 was misplaced because Section 3 is merely a mechanism for enforcing state law rights recognized and protected by Section 2. They contend Section 2 and the state law principles it applies resolve the issue of a nonsignatory's rights and obligations under an arbitration agreement subject to the FAA. Although Section 3 certainly requires the existence of a written arbitration agreement, the petitioners say that nothing in Section 3 or Section 2 requires that the arbitration agreement be signed. Finally, the petitioners declare that the absence of a signature requirement under the Federal Arbitration Act reflects the often informal nature of regular commercial practices and a concern about the dampening effect excessive formalities can have upon arbitration.

The respondents explain that the rules the parties ask the Supreme Court to adopt differ in the following respects. Under petitioners' proposed rule, an order refusing a nonsignatory's arbitration-related stay request is immediately appealable if the underlying stay application merely alleged Section 3 as its basis. Under this rule, the label a movant places on its stay application would be the binding jurisdictional determinant for any interlocutory appeal from the application's denial. This would leave interlocutory appellate jurisdiction, which congressional policy disfavors and must be narrowly construed, entirely in the hands of the stay applicant's lawyer, inviting all manner of gamesmanship and manipulation. In contrast, the respondents say the rule they espouse recognizes that, regardless of the label a movant might place on its stay motion or that a district court might place on its order denying such motion, nonsignatories relying on equitable estoppel cannot seek arbitration-related stays under Section 3 because, by definition, their stay request cannot satisfy Section 3's "referable to arbitration under an agreement in writing" requirement.

In choosing the rule respondents espouse and dismissing petitioners' appeal based on a lack of interlocutory jurisdiction, the respondents say the Sixth Circuit decision properly steered well clear of the merits of petitioners' appeal. It is the respondent's position that, whenever possible, such jurisdictional rules must be clear, predictable, bright-line rules that can be applied to determine jurisdiction with a fair degree of certainty from the outset. Respondents argue that those, like petitioners, who chose not to enter into arbitration agreements with respondents, and who instead had to resort to equitable estoppel to attempt to force respondents to arbitrate, simply are not eligible for interlocutory appeals under Section 16. Respondents conclude the federal policy favoring consensual arbitration cannot be stretched far enough to sanction the nonvolitional arbitration that the petitioners' stay request envisions.

Significance

Parties to arbitration proceedings become so by virtue of contract. General contract rules control as to who is entitled to the benefit of, and who is bound by, an agreement to arbitrate. There is some authority for the view that a district court has discretion to permit nonsignatories to an agreement with an arbitration clause to compel signatories to arbitrate their claims. The petitioners claim they are entitled to an order staying the judicial proceeding based on the theory that equitable estoppel should prevent the respondents from avoiding arbitration under the contracts between the respondents and Bricolage Capital. (It has been held that the application of equitable estoppel is warranted when the signatory to a contract containing an arbitration clause raises allegations of substantially interdependent and concerted misconduct by both a nonsignatory and one or more of the signatories. See, e.g., *Grigson v. Creative Artists Agency, L.L.C.,* 210 F.3d 524 (5th Cir. 2000).) The question in this proceeding is limited to the question of whether an appellate court has jurisdiction to hear an appeal from a denial of a motion to stay arbitration when the petitioners were not signatories to the arbitration agreement.

This jurisdictional question has been addressed by at least three other circuits in addition to the Sixth Circuit. *DSMC Inc. v. Convera Corp.,* 349 F.3d 679 (D.C. Cir. 2003), held that because there was no written agreement between DSMC and Convera there was no jurisdiction to review the district court's decision denying a motion to stay judicial proceedings. In re *Universal Service Fund Telephone Billing Practice Litig. v. Spring Communications Co., L.P.,* 428 F.3d 940 (10th Cir. 2005), the court left open the possibility that nonsignatories might be compelled by principles of equitable estoppel to arbitrate, and dismissed for lack of jurisdiction an interlocutory appeal from the district court's denial of a motion to stay proceedings. On the other hand, *Ross v. American Express Co.,* 478 F.3d 96 (2d Cir. 2007), held that defendants could appeal the district court's refusal to compel arbitration even though the defendants were not signatories to the arbitration agreement, when the claims against the defendants were "inextricably intertwined" with the arbitration agreements that met the writing requirement of the Federal Arbitration Act).

The Supreme Court now has the opportunity to resolve the conflict among the circuits. The Court may also take this case as an opportunity to clarify when nonsignatories to an arbitration agreement may be able to compel arbitration under the agreement.

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Amicus Briefs

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